

DISCONTINUING DISCOUNTING?

At the Institute Annual General Meeting in May it was refreshing to hear the then Director of the Institute of Economic Research (Inc.), Brian Easton, admitting that "the time dimension creates very great problems in economics, and the good economists always approach time-dependent problems with the greatest respect".

For foresters, such an observation is very pertinent, for many have been uneasy about the uncritical use of discounting which they felt that economists were insisting upon. The effects of discounting at a 10% real rate, as the N.Z. Forest Service has practised, has had profound effects on forestry. It has virtually confined production plantation forestry to radiata pine grown on short rotations. It has also had a large influence on tending practices, land acquisition and restricted our thinking and management of indigenous species. The use of short rotations has important consequential effects on intrinsic wood properties in species like radiata pine, and influences the timing and nature of industrial expansion. It also influences stumpage expectations when the wood is sold, and is often involved in valuation exercises (see review by B. Everts, p. 30).

But what was the rationale behind the choice of a real 10% discount rate used by State? John Purey-Cust, our former editor, wrote to the Treasury seeking the information under the Official Information Act. The reply contained a copy of a review paper on the public service discount rate prepared by Dr. B.D. Wilkinson in 1981. This review considered seven suggested methods of deriving a suitable rate, all of which were based on economic criteria. Some of the more important points made were:

- The common assumption that the Public Service discount rate should be the same as the social rate of time preference (i.e. the marginal productivity of capital in the private sector) "is not necessarily optimal".
- "It is reasonably safe to conclude that the rate of return on capital at the margin in the private sector is at least 10%".
- "The major conclusion therefore is that determining the Public Service discount rate is inevitably a political/democratic decision which must involve weighing of social opportunity cost, rate of time preference, cost

of overseas and internal borrowing issues. It is impossible to determine the optimal rate independently of a knowledge of the implications of that rate for the volume of capital expenditures and taxation. In fact causation primarily runs in the other direction. During the course of the budgetary process Governments determine the desired rate of public investment taking all relevant rates of return, internal/external balance and tax considerations into account. Given the menu of investment opportunities this quantity decision determines the cut-off Public Service discount rate."

In this issue Jeanette Fitzsimons argues for a much wider perspective and the use of different criteria for decision making (see page 22).

If her arguments are heeded they

could change the direction of forestry. Her wider perspective makes the Treasury report on Public Service discount rates appear rather narrow. Also recently we have seen the larger forestry companies employing discount rates substantially under the 10% criteria (see page 23). Will Government moves to create State Corporations, which will be more subject to market forces and will be funded independent of taxation, have repercussions on the use of discounting? Will the Government now accept wider criteria for funding the new departments without trading functions? Perhaps, as Brian Easton commented at our Annual General Meeting, whereas discounting methods have dominated in recent years, they may not in the future.

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PRESIDENTIAL ADDRESS 1986

"We trained hard. But it seemed that every time we were beginning to form up into teams we would be reorganised. I was to learn later in life that we tend to meet any new situation by reorganising; and a wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency and demoralization."

— Petronius Arbiter,
210 B.C.

I am grateful to Mr A. L. Poole for drawing my attention to this quotation. I believe it is as appropriate today as it was in 210 B.C.

The Editor of Australian Forestry in his comments on the 1985 Conference in Hobart said of the keynote speech that it had "a pronounced impact on the Conference and was the basis of much discussion throughout the week".

Catherine West, the keynote speaker, said that the then new New Zealand Government appeared to her to be committed to conservation, and to be engaged in the potentially dangerous debate about the possible administrative separation of development and conservation. This suggestion, she said, is the antithesis of professional forestry, which has to be concerned with the balance

between these two related areas. Good forestry, like good politics, she claimed, is a matter of time. Preservationists have, in her opinion, no interest in timing, as they desire only to preserve what is. Professional foresters, on the other hand, are concerned to balance what is with what needs to be. Foresters, she said, combine a desire to minimise damage and maximise community opportunity and benefit.

Since the Hobart Conference we have seen massive changes within New Zealand to the administration of public forests. There are also proposed fiscal changes which, if adopted, will have a profound effect on the management of privately owned forests. Over the past 12 months, the New Zealand Institute of Foresters has, at every opportunity, been active in commenting loudly and strongly to Government on these proposed changes.

The original direction Government took seemed to be towards the fragmentation of State forest administration into the artificially separate conservation and production components. This appeared to most responsible land managers to be a total Government sell-